# PRIVATE SECURITIES LITIGATION/Veto Override

**SUBJECT:** **Private Securities Litigation Reform Act of 1995 . . . H.R. 1058. Passage, upon reconsideration, the objections of the President notwithstanding.**

## ACTION: VETO OVERRIDDEN, 68-30

**SYNOPSIS:** On March 8 the House passed H.R. 1058 by a vote of 325-99, and on June 28 the Senate passed it by a vote of 69-30, with one Senator voting present (see vote No. 295). On December 5, the Senate passed the conference report to accompany H.R. 1058 by a vote of 65-30, with one Senator voting present (see vote No. 589). The House passed the conference report on December 6 by a vote of 320-102. President Clinton vetoed H.R. 1058 on December 19. The House voted 319-100, with one member voting present, to override his veto on December 20.

H.R. 1058, the Private Securities Litigation Reform Act, will enact changes to current private securities litigation practices in order to discourage unjust suits and to provide better information and protection from fraud for investors. Details are as follows:

- brokers or dealers will be prohibited from soliciting or receiving any type of fee or remuneration for helping an attorney in obtaining representation of a customer in private actions;
- a court will determine if attorneys may be barred from representing a client in a securities lawsuit if their ownership of stock subject to that suit creates a conflict of interest or if another conflict of interest exists that is sufficient to justify barring their representation;
- it will generally be prohibited to pay attorney's fees from disgorgement funds;
- each plaintiff who seeks to serve as a representative in a class action lawsuit will have to present a sworn certification of several factors, including that he or she was not hired by a lawyer to file suit and that he or she will not receive a bonus for serving as a class representative;
- a class representative's recovery in a suit will be limited to his or her pro rata share of the settlement or final judgment (though this section will not bar a court from awarding reasonable costs and expenses, including lost wages, directly related to representation);
- the filing of settlements under seal will be prohibited unless "good cause" is shown;

(See other side)

**YEAS (68)**

| Republicans (48 or 92%) | | Democrats (20 or 43%) |
|---|---|---|
| Abraham | Helms | Baucus |
| Ashcroft | Hutchison | Bingaman |
| Bennett | Inhofe | Bradley |
| Brown | Jeffords | Dodd |
| Burns | Kassebaum | Exon |
| Campbell | Kempthorne | Feinstein |
| Chafee | Kyl | Ford |
| Coats | Lott | Harkin |
| Cochran | Lugar | Johnston |
| Coverdell | Mack | Kennedy |
| Craig | McConnell | Kerry |
| D'Amato | Murkowski | Kohl |
| DeWine | Nickles | Lieberman |
| Dole | Pressler | Mikulski |
| Domenici | Roth | Moseley-Braun |
| Faircloth | Santorum | Murray |
| Frist | Simpson | Pell |
| Gorton | Smith | Reid |
| Gramm | Snowe | Robb |
| Grams | Stevens | Rockefeller |
| Grassley | Thomas | |
| Gregg | Thompson | |
| Hatch | Thurmond | |
| Hatfield | Warner | |

**NAYS (30)**

| Republicans (4 or 8%) | Democrats (26 or 57%) |
|---|---|
| Cohen | Akaka |
| McCain | Biden |
| Shelby | Boxer |
| Specter | Breaux |
| | Bryan |
| | Bumpers |
| | Byrd |
| | Conrad |
| | Daschle |
| | Dorgan |
| | Feingold |
| | Glenn |
| | Graham |
| | Heflin |
| | Hollings |
| | Inouye |
| | Kerrey |
| | Lautenberg |
| | Leahy |
| | Levin |
| | Moynihan |
| | Nunn |
| | Pryor |
| | Sarbanes |
| | Simon |
| | Wellstone |

**NOT VOTING (0)**

| Republicans (0) | Democrats (0) |
|---|---|

**VOTING PRESENT(1)**

Bond

**EXPLANATION OF ABSENCE:**

1—Official Buisiness
2—Necessarily Absent
3—Illness
4—Other

**SYMBOLS:**

AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

● attorney fees awarded by a court to counsel for a plaintiff will be limited to a "reasonable" percentage of the amount of recovery for the class;

● for any proposed or final settlement agreement to a class action lawsuit, the class will have to be informed: of the amounts of damages that the settling parties believe will be collected, on a per-share basis (if there is disagreement each party will have to state the amount it believes will be collected); any intention to use part of the award to pay legal fees; the reason for any proposed settlement; and other specified information;

● after a complaint is filed, it will be published so that members of the purported class may learn of the complaint and, within 60 days, apply to be lead plaintiff;

● a rebuttable presumption will be established that the plaintiff with the largest financial stake in an action should be named lead plaintiff (see vote No. 287 for related debate);

● the lead plaintiff will select the lead counsel;

● upon final adjudication of a private securities action, a judge will review the record for compliance with rule 11 of the Federal Rules of Civil Procedure (which bars frivolous, harassing, and other legal maneuvers), and will require any party guilty of rule 11 violations to pay the other parties legal fees for the entire action, with exceptions (see vote No. 291 for related debate);

● discovery will generally be stayed upon a motion to dismiss (see vote No. 292 for related debate);

● plaintiffs alleging untrue statements of material facts, or the omission of material facts necessary to keep statements from being misleading, will specify in their pleadings the statements and omissions forming the basis of their allegations, and why they believe their allegations are true;

● to make pleadings based on the defendant's state of mind, a plaintiff will have to allege facts with particularity that give strong inference that the defendant acted with the required state of mind;

● a safe harbor from securities litigation will be created for forward-looking statements, whether written or oral, that are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially (the "bespeaks caution" test); numerous exemptions from this safe-harbor, mostly for certain types of businesses, will be made (for related debate, see vote Nos. 288-289 and 294);

● in private actions, defendants will have the right to a written interrogatory for each allegation based on their state of mind;

● application of the Racketeer Influenced and Corrupt Organizations (RICO) Act to securities suits will be limited;

● the SEC will be given statutory authority to prosecute knowing aiders and abettors of securities fraud who provide substantial assistance in committing that fraud (see vote No. 286 for related debate);

● a defendant will not have to pay damages to a plaintiff for losses unrelated to misstatements or omissions which caused a securities loss;

● a study will be done of the protection senior citizens are afforded by this Act from securities fraud (see vote No. 285);

● in general, in actions seeking damages in reference to the market price of a security, a plaintiff's damages will not exceed the difference between the purchase or sale price, as appropriate, by the plaintiff for the security and the median market price in the 90 days after the defendant corrects the misstatement or omissions;

● joint and several liability will be retained for defendants who "knowingly" commit securities fraud, but a modified proportionate liability standard will be applied to defendants who are found guilty of "reckless" conduct (the proportionate liability standard is the same as in the Senate-passed bill; see vote No. 284 for related debate);

● plaintiffs may be required to post bonds in case their actions are ruled frivolous and they consequently have to pay defendant's costs; and

● independent public accountants will be required to notify a company's management of any illegal activity they discover, and if the management fails to act, they will be required to notify the company's board of directors, and if the board of directors fails to notify the SEC within 1 day, they must notify the SEC the following day.

NOTE: A yea vote was a vote to override the President's veto; a nay vote was a vote to sustain the veto. A two-thirds majority of those present and voting (66 in this case) is required to override a veto.

**Those favoring** overriding the President's veto contended:

This bill was first introduced in 1991. From the beginning, it has had bipartisan support. There have been 12 public congressional hearings, 95 witnesses have testified, and more than 4,000 pages of testimony have been taken. This year, there have been 7 full days of debate on it on the Senate floor. Over the years the support for this effort has gradually grown as Members in both Houses have become familiar with the issue, and, significantly, the effort has remained strongly bipartisan. Few Members dispute that reforms are needed to stop lawyers from filing abusive securities suits. More than two-thirds of Members in both bodies also agree that the provisions of this bill as it passed Congress are praiseworthy. The President himself has found very little to object to in the bill. In fact, of the 11,000 words in the bill, he has objected to 11. Those 11 words cover 3 areas: pleading standards; rule 11 reform; and the safe harbor for forward looking statements.

His main objection to the pleading standards (which determine when a plaintiff may sue based upon a defendant's alleged state

of mind) is that they do not contain the Specter amendment language that was agreed to by the Senate during debate. However, in June of 1995, he praised the pleading standards in the Senate-reported bill as "sensible and workable." That praise came before Senator Specter had offered his amendment. In other words, he is threatening to veto a bill for containing language that he previously called sensible and workable. The conferees were correct to drop the Specter amendment. It purported to copy court-created evidentiary standards, but it offered an incomplete, and thus inaccurate, version of those standards--it failed to require that when a motive was not apparent, the strength of circumstantial allegations would have to be correspondingly greater. President Clinton has also objected to the fact that the conferees changed three words from the Senate-reported language--instead of saying that a plaintiff who is making a claim based on the defendant's state of mind must "specifically allege facts giving rise to a strong inference of fraud," the report says the defendant must "state with particularity facts giving rise to a strong inference of fraud." That change was made on the recommendation of the Judicial Conference in order to conform with rule 9(b) of the Federal Rules of Civil Procedure, which governs how attorneys should draft fraud complaints. Making that change added clarity and consistency to the law without changing the standard substantively. Frankly, without meaning any disrespect, the issue of pleading standards is very minor in the overall context of this bill. We believe the President was given very bad advice if he was told he should veto this bill because of this section.

The next excuse the President has given for vetoing this bill is that the conference language on rule 11 (rule 11 allows judges to impose penalties for abusive actions of defendants and plaintiffs) is not exactly the same as the language in the Senate-passed bill. The language is slightly different, but the intent is the same. The change was made for clarity. The Senate adopted a sanction for rule 11 that would allow a victim of a violation to collect the legal fees and costs incurred as a direct result of the violation. The conference report simple makes clear that it was the Senate's intention that in the case of a substantial violation in an initial pleading, all of a defendant's costs and fees would be recoverable, because they all would be a result of that substantial violation. Our colleagues and the President complain that this clarification is not fair because it does not leave open the means for a plaintiff to recover the costs and fees of an entire action. However, this complaint does not make any sense. Plaintiffs bring actions--how could a plaintiff logically allege that the costs of his bringing a meritorious action were due to a rule 11 violation that had not yet occurred? As soon as a defendant makes a rule 11 violation, a plaintiff may recover for any costs and fees that stem from that violation, but, as a matter of obvious common sense, one cannot recover damages for an injury that has yet to occur.

The third item the President has chosen to base his veto on is the safe harbor language. The President wrote in his message that he endorses the language in the bill; he only objects to the language in the explanatory statement accompanying the bill. This excuse is perhaps the thinnest ever we have heard for vetoing a bill. The President likes the bill language (which the Securities and Exchange Commission has endorsed), yet he does not think a reference to it in the managers' explanation is supportable. Again, we believe the President has received some very bad advice.

We think we know the source of that advice. The Washington Times reported that, "According to Administration aides, the crucial moment came when New York University Law School Professor John Sexton visited the White House to personally argue that the legislation should be vetoed." John Sexton is not a law professor; rather, he is the dean of that law school. A primary function of any dean is to raise funds. Dean Sexton raised $1 million from Mr. and Mrs. Melvin Weis, who also led a campaign to raise another $5 million. Mr. Weis is the Weis in Milberg, Weiss, Bershad, Haynes, & Lerach, which is the leading securities litigation plaintiffs firm. In other words, President Clinton sought professional, non-biased advice, and he received advice from a vested interest posing as an outside expert observer.

We know that many Democrats are reluctant to override a veto of a President who is a Democrat, but we remind them that they have obligations to Senator Dodd as well. Senator Dodd has put in countless hours working on this legislation. He has also worked countless hours on behalf of all Democrats as Chairman of the Democratic National Committee. We remind those Senators that they voted for the exact provisions of this bill only a few days ago, that President Clinton's objections to it are very minor, and, if it were not for last-minute bad advice, he probably would have signed it. The House has already voted to override this veto; the Senate should now follow suit.

**Those opposing** overriding the President's veto contended:

We opposed this bill when it passed the Senate, we opposed the conference report, and we will of course oppose overriding the President's veto. Frankly, we think the reasons for voting to uphold the President's veto go well beyond the reasons that the President lists. We have thoroughly gone over those issues in the past (see vote Nos. 295 and 589). This bill will place such tight limits on suits for securities fraud that it will virtually eliminate the right to sue, whether the claim is abusive or meritorious. Our colleagues have heard our arguments before and have not been swayed. We are hopeful that they will find President Clinton more convincing, and will join us in upholding his veto.

President Clinton, in his veto message, finds less to object to in this bill than do we. In fact, his concerns are confined to just three areas: the pleading standard, the safe harbor provisions, and the rule 11 provisions. A pleading standard sets the requirements that must be met in order to bring suit. The standard in question sets the requirements that must be met when the pleading is based on a defendant's state of mind. The highest standard currently used is by the U.S. Court of Appeals for the Second Circuit. This bill codifies that standard. However, a Specter amendment that would have codified the specific evidentiary standards that the court

adopted in a later case did not make it into the conference report. Our colleagues tell us that the reason they were not included was that they were not exactly the same as the court's standards. However, the Statement of Managers indicated that the reason they were not included was that they wanted it to be possible to impose even higher evidentiary standards. The President noted that he would be willing to codify the highest pleading and evidentiary standards now in existence, but he could not accept allowing even higher standards. We agree; it should not be made so difficult to sue.

More disturbingly, the pleading standard was also changed. The report will require plaintiffs to plead "with particularity" the facts giving strong inference that the defendant acted with a certain state of mind. Our colleagues tell us that this change was done to conform with rule 9(b). Rule 9(b), as our colleagues state, requires that fraud be pleaded with particularity. However, our colleagues fail to note that rule 9(b) also says that when dealing with state of mind, particularity is not required because it is not realistic to require it. The rule states that state of mind can be "averred generally." Changing the pleading standard in this manner thus does not simply conform the standard to rule 9(b), as our colleagues allege; it sets an unrealistic standard that will make it nearly impossible to ever bring a suit based on a defendant's state of mind. We find this change to be extreme and ample reason to veto this bill.

The President's next objection is to the safe harbor provision for forward-looking statements. He does not object to the language in the bill itself, but to the language in the Statement of Managers on the conference report. We add that we object to the bill language as well. The language is so broad that it will cover outright lies as long as they are made by predictions and accompanied by disclaimers that actual results may vary.

The final reason President had for vetoing this bill is that it will give an unfair rule 11 advantage to defendants. Under the terms of the conference report, but not the Senate-passed bill, it will be possible for a defendant to recover all costs and fees in a case if the initial pleading is ruled to have substantially violated rule 11. No similar relief will be available for plaintiffs. This provision will allow huge corporations to threaten small investors they have defrauded with lengthy court battles and the possibility that in the end they may have to pay the company's costs. This threat will discourage many legitimate suits.

The President's objections to this bill are reasonable. If his veto is upheld, we are confident that it will be possible to pass a new bill that will be acceptable to him, and will be better for investors. We urge our colleagues to take this opportunity by voting to sustain President Clinton's veto.